STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: INTERSTATE POWER AND LIGHT COMPANY	DOCKET NO. RPU-02-7

FINAL DECISION AND ORDER

(Issued May 15, 2003)

APPEARANCES

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I. PROCEDURAL HISTORY

On July 15, 2002, Interstate Power and Light Company (IPL) filed with the Utilities Board (Board) proposed gas tariffs, identified as TF-02-424 and TF-02-425. In TF-02-424, IPL proposed a temporary increase that would produce additional revenue of approximately $18,640,899. In TF-02-425, IPL proposed a permanent annual revenue increase of approximately $20,070,773, or an overall annual revenue increase of 7.2 percent. The Board issued an order on August 14, 2002, docketing the application as Docket No. RPU-02-7, suspending the proposed tariffs, and establishing a procedural schedule.

Intervention in this proceeding was granted by the Board on September 17, 2002, to Archer Daniels Midland Company (ADM), Equistar Chemicals, LP (Equistar), MidAmerican Energy Company (MidAmerican), Northern Natural Gas Company (NNG), and U.S. Energy Services, Inc. (U.S. Energy). On October 4, 2002, the Board issued an order granting IPL a temporary increase in gas revenues of $16,909,274.

In accordance with the procedural schedule, IPL, Consumer Advocate, and ADM and Equistar filed prepared testimony. MidAmerican, NNG, and U.S. Energy did not file testimony. On February 2, 2003, the parties filed a statement of issues. A hearing was held on February 17 through 19, 2003.

At the hearing in this proceeding, the Board granted a motion to take official notice of the testimony and evidence from IPL's electric rate proceeding, Docket

Nos. RPU-02-3, RPU-02-8, and ARU-02-1. The Board issued a "Final Decision And Order" in the electric rate proceeding on April 15, 2003.

Briefs have been filed by IPL, Consumer Advocate, MidAmerican, and ADM and Equistar. The contested issues raised will be addressed by the Board in this order. Some of the issues in this proceeding are the same or similar to those addressed by the Board in the April 15, 2003, order in the electric rate proceeding. The Board will indicate in its discussion of the issues where the issue is similar to the issue decided by the Board in the April 15, 2003, order.

II. RATEMAKING PRINCIPLES

IPL and Consumer Advocate addressed proper "ratemaking principles" that the Board should apply to this proceeding. The discussion of ratemaking principles affects the "year end rate base" issue, the "Enterprise Resource Planning (ERP)" issue, the "Vehicle Replacement Program" issue, and the "Gas Code Compliance" issue. While the ratemaking principles discussed provide useful guidance in addressing rate base and income statement adjustments, Iowa law mandates one overriding ratemaking principle for the Board. Iowa Code § 476.8 directs that the Board is to determine rates that are "just and reasonable." Other ratemaking guidelines or principles addressed in Chapter 476, such as the use of an historical test year, known and measurable adjustments, and the matching principle should be viewed as tools available to the Board to reach a determination of just and reasonable rates.

Consumer Advocate in its briefs categorized three ratemaking principles as controlling in this proceeding. The three identified by Consumer Advocate are the test year principle, the matching principle, and the pro forma adjustment principle. IPL addressed these same principles in its briefs.

The test year is addressed in Iowa Code § 476.33(4) which provides as follows:

> The board shall adopt rules that require the board, in rate regulatory proceedings under sections 476.3 and 476.6, to consider the use of the most current test period possible in determining reasonable and just rates, subject only to the availability of existing and verifiable data respecting costs and revenues, and in addition to consider verifiable data that exists as of the date of the commencement of the proceedings respecting known and measurable changes in costs not associated with a different level of revenue, and known and measurable revenues not associated with a different level of costs, that are to occur at any time within twelve months after the date of commencement of the proceedings. For purposes of this subsection, a proceeding commences under section 476.6 upon the filing date of new or changed rates, charges, schedules or regulations. This subsection does not limit the authority of the board to consider other evidence in proceedings under sections 476.3 and 476.6.

Under this section, the Board has generally used the historic test year concept as the starting point for setting rates. In this proceeding, the test year is calendar year 2001. However, the Board has also recognized the regulatory lag inherent in the use of a historical test year and has consistently allowed post-test year adjustments in appropriate circumstances, e.g., when all changes to costs and revenues can be calculated.

In tandem with the historic test year, Consumer Advocate addressed a pro forma adjustment principle. Consumer Advocate argued that a pro forma adjustment is not permitted unless: (1) the effect of the change giving rise to the adjustment is known and measurable using verifiable data that exists on the date the proceeding commenced, (2) the change is not associated with a different level of sales, revenue, or cost, and (3) the change will occur within 12 months of the date the proceeding commenced. According to Consumer Advocate's argument, the Board, pursuant to Iowa Code § 476.33(4), cannot consider pro forma adjustments that are not supported by existing and verifiable data at the commencement of the proceeding. Consumer Advocate has consistently made this argument in the past but the Board has rejected it because it ignores the last sentence of the subsection, which provides that "[t]his subsection does not limit the authority of the board to consider other evidence in proceedings under sections 476.3 and 476.6." There are numerous examples of the Board allowing pro forma adjustments not supported by existing and verifiable data at the time of filing of the rate case.

Historic test year and pro forma adjustments are only a part of the ratemaking process. Another and perhaps more important principle is the known and measurable standard. Even the use of this standard, however, is not mandated by statute. The statute only requires that the Board "consider" such information in setting rates. The last sentence of section 476.33(4) gives the Board broad latitude in considering information, with the overall statutory standard setting "just and reasonable rates." The statute does not rule out the Board's use of judgment and common sense in setting rates.

The Board in its rules characterizes the known and measurable changes as follows:

> In rate regulatory proceedings under Iowa Code sections 476.3 and 476.6, the board shall consider verifiable data, existing as of the date of the commencement of the proceedings, respecting known and measurable changes in costs not associated with a different level of revenue and known and measurable revenues not associated with a different level of costs, that are to occur within 12 months after the date of the commencement of the proceedings. 199 IAC 7.11(2).

In other words, under the Board's rules, known and measurable changes that can be verified as of the date of filing, even if they do not occur until 12 months after the date of commencement of the proceedings, can be considered. Once again, however, the rule does not limit the Board's consideration of other evidence. In fact, known and measurable changes that occur after the date of filing could be considered and adopted.

Related to the known and measurable standard is Consumer Advocate's third ratemaking principle, the matching principle. The matching principle is a fundamental principle of test year ratemaking that provides that changes in the level of investment or in the level of some types of operating expenses will almost always be associated with a different level of revenue. Unless these changes in the level of costs are matched with corresponding changes in revenue, the test year is not a proper one for fixing just and reasonable rates. The inclusion of costs without the matching revenues will produce excessive rates. The inclusion of revenues without the matching costs will deny the utility reasonable rates. Davenport Water Company v. Iowa State Commerce Comm'n, 190 N.W.2d 583, 605 (Iowa 1971).

However, before the matching principle even comes into play, an increase in expenses or revenues resulting from a pro forma adjustment must be shown. For example, in Northwestern Bell Telephone Company v. Iowa State Commerce Comm'n, 359 N.W.2d 491 (Iowa 1984), the Iowa State Commerce Commission (ISCC), predecessor to the Board, made an adjustment because it was shown that a decline in the number of employees would occur. Northwestern Bell contended that under the matching principle there should be a corresponding adjustment for a resulting increase in other expenses, such as for automated equipment. The ISCC had not made an adjustment for any increased expenses.

The Iowa Supreme Court reversed a district court finding that the ISCC had to make an expense adjustment for a resulting increase in expenses. Under the statute, "verifiable" data and "known and measurable" costs and revenues must appear before the matching principle comes into play. Northwestern Bell's claim of increased costs rested only on speculation. The matching principle was not applicable because the resulting increase in expenses was not shown. Id.

The final related concept that is important to this case is the "used and useful" standard. Used and useful is derived from United States Supreme Court holdings that a utility is entitled to a reasonable return on the value of property used to render services, but it is not entitled to have included any property not used or useful for that purpose. Denver Union Stockyard Co. v. United States, 304 U.S. 470,475, 58 S. Ct. 990, 994, 82 L.Ed 1469, 1476 (1938); Iowa-Illinois Gas & Elec. v. Iowa State Commerce Comm'n, 347 N.W.2d 423, 428 (Iowa 1984). The rule is based on the premise that, as economic captives, consumers should only pay for the utility properties that are actually used or useful in rendering services to them.

While the ratemaking principles discussed above are important in the Board's analysis of the issues, particularly with respect to rate base and income statement adjustments, none of the standards are controlling in a particular instance. The primary statutory directive for the Board is to set "just and reasonable" rates and exceptions to the various ratemaking principles are justified if they further that statutory goal.

III. TEST YEAR

The test year for this proceeding is calendar year 2001. Numerous pro forma adjustments to the test year were proposed. Adjustments that were contested by one or more of the parties at hearing will be addressed in the order; all adjustments that were uncontested will be reflected in the schedules attached to this order.

IV. RATE BASE ISSUES

A. Year End Rate Base

IPL proposed a pro forma adjustment to rate base to reflect annualized year-end plant in service less accumulated for depreciation and amortization and accumulated deferred income taxes. IPL's adjustment effectively annualizes all additions and retirements for calendar year 2001. IPL proposed a corresponding customer revenue adjustment based upon year-end customer accounts. IPL argued that its proposed adjustment does not violate the matching principle.

Consumer Advocate opposed the year-end rate base adjustment. Consumer Advocate argued that the year-end rate base adjustment violates the matching principle and the Board precedent of using a 13-month average rate base.

The Board finds that adoption of the year-end rate base as proposed by IPL would be a dramatic change in Board precedent regarding test year and pro forma adjustments. A year-end rate base raises matching issues that have not been adequately addressed by IPL and the Board is not convinced that all matching revenue issues are captured by IPL's proposal.

The Board has allowed the inclusion of pro forma adjustments that involve specific projects with evidence of proper matching of revenue and costs in other cases and continues to support those types of changes where supported by the evidence in the record. In this proceeding, the evidence is not persuasive that the Board should adopt a year-end rate base.

B. Vehicle Replacement Program

IPL proposed an adjustment of $427,827 to rate base for the cost of the vehicle replacement program. This is based upon a replacement of 10 percent of vehicles each year. IPL confirmed that all units were placed in service shortly after the end of 2002. Exhibit 2, revised schedule D-35, shows a cost savings of $5,775.

Consumer Advocate opposed the adjustment as violating the matching principle. Consumer Advocate proposed a $134,371 adjustment as known and measurable. Consumer Advocate argued that IPL's adjustment was based upon budgeted amounts that were not in service at the commencement of the rate proceeding.

The Board finds that the evidence in IPL late-filed Exhibit 18 shows that the vehicles allocated to gas service are known and measurable and in service at a replacement amount of $461,000. IPL requested an adjustment to test year rate base of $436,000 and has made an adjustment for savings related to the rate base adjustment. Minus accumulated depreciation of ($8,173), the net adjustment is $427,827. The Board finds that IPL's adjustment is reasonable and will be adopted. This decision is different than the decision in the electric rate proceeding since IPL did not show in that proceeding that the cost of the vehicles was known and measurable and the vehicles were in service.

C. Enterprise Resource Planning

IPL proposed that the costs associated with installation and implementation of the PeopleSoft Enterprise Resource Planning (ERP) application be included in rate base for this proceeding. IPL replaced its software in seven major areas involving the core back office processes and systems. The adjustment adds $3,075,005 to rate base, minus accumulated depreciation of ($307,500) and minus material and supplies of ($292,601). The software was in service on October 1, 2002.

Consumer Advocate opposed the adjustments because the system did not go into service in July 2002 as planned, there is no adjustment for cost savings, and the five-year amortization is too short, causing a mismatch of the ratemaking equation components.

This issue is essentially the same as the issue in the electric rate proceeding. The Board finds the evidence supports the same result in this proceeding. The ERP project was in service in October 2002, was used and useful, and the costs were known and measurable. Cost savings were included in the adjustment, including reduced information technology staffing and lower materials and inventories. Allowing recovery for major expenditures that are known and measurable during the time it takes to complete a rate case is consistent with Board precedent. The Board will accept IPL's proposed adjustments.

V. INCOME STATEMENT ISSUES

A. Year End Rate Base

Since the Board did not adopt the year-end rate base as proposed by IPL, the Board will not adopt any corresponding income statement adjustments.

B. Vehicle Replacement Program

The income adjustments for the vehicle replacement program correspond to the rate base adjustments addressed above and the Board finds that the adjustments are reasonable and will be approved. The income adjustments are as follows:

Operating expense	($5,775)
Depreciation	$16,347
Federal income tax	($3,326)
State income tax	($1,069)
Net effect	$6,177

C. Enterprise Resource Planning (ERP)

The income statement adjustments for ERP correspond to the ERP rate base adjustments addressed above. The Board finds that the income adjustments for ERP are reasonable and will be adopted. The adjustments are as follows:

Operating expense	$5,790
Depreciation	$615,001
Federal income tax	($195,301)
State income tax	($62,762)
Net effect	$362,727

D. Interest Synchronization

IPL proposed an adjustment to actualize the amount of estimated interest expense used in IPL's income tax calculation. It presented the imputed interest expense based on the rate base and weighted average cost of debt as proposed by IPL. Consumer Advocate used the same calculation as IPL, but used its proposed values for rate base and weighted cost of debt. Consumer Advocate argued that ratepayer funds are mixed with other Alliant Energy Corporation (AEC) funds to pay interest on Alliant Energy Resources (AER) debt and, therefore, ratepayers paid more in taxes than AEC.

The resolution of this issue flows from the level of rate base and weighted cost of debt issues. Those issues are addressed elsewhere in this order and the interest synchronization calculation will be consistent with those decisions.

E. Net Merger Benefits

IPL proposed a $90,300 adjustment to the income statement associated with the IES Utilities Inc. and Interstate Power Company merger effective January 1, 2002. The final revenue requirement exhibits show that IPL has accepted the savings adjustment proposed by Consumer Advocate.

Consumer Advocate proposed an additional adjustment to recognize the gas portion of the claimed merger savings in Docket No. SPU-96-6, IES Utilities Inc. and Interstate Power Company.

This issue was addressed in the electric rate proceeding, where the Board found that there should be no additional adjustment because there was insufficient evidence to support an amount. The Board finds that the evidence in this proceeding also does not support any additional adjustment.

F. Management Incentive Compensation Plan and Employee Incentive Compensation Plan Awards

IPL proposed to include awards to employees associated with the Management Incentive Compensation Plan (MICP) and the Employee Incentive Compensation Plan (EICP). These plans are designed to provide incentives to IPL managers and employees based upon company performance, business unit performance, and individual performance. IPL argued that these plans directly benefit customers by establishing performance measures tied to customer service, customer satisfaction, system reliability, safety, and environmental stewardship, in addition to financial measures. IPL argued without the plans it would have to increase salaries.

Consumer Advocate argued that the incentive compensation payments include non-recurring costs that are tied to company and business unit performance that will not be attained in 2003. Consumer Advocate argued that AEC will not attain the company and business unit standards for the incentive payments.

This issue is identical to the issue addressed by the Board in the electric rate proceeding. In that proceeding the Board accepted Consumer Advocate's adjustment finding that "it is undisputed that no payments were made for 2002 and, based on the financial targets currently contained in the plans, it is not known when payments may resume." Interstate Power and Light Company, "Final Decision and Order," issued April 15, 2003. The Board accepted Consumer Advocate's adjustment and included zero as the most reasonable representative amount to include in rates for the plans. The evidence in this proceeding supports the same result.

G. Other Post Employment Retirement Costs

IPL proposed an adjustment to post-employment benefits other than pensions (OPEB) to recover increases in those costs based upon two components. First, the direct costs for the former IES and IPC employees and, second, the indirect costs for the IPL affiliate service company, Alliant Energy Corporation Services. IPL relied on a study by its actuary, Towers Perrin, in determining the appropriate level of costs to include in rates.

Consumer Advocate recommended use of a three-year average for OPEB costs. Consumer Advocate proposed a three-year average because the costs have fluctuated significantly over the past four years due to changes in discount rates and medical trends. Consumer Advocate asserted that IPL has the ability to significantly influence those rates and, therefore, the costs.

The Board addressed this issue in the electric rate proceeding and the evidence in this proceeding is substantially the same. The Board found that Consumer Advocate’s three-year average approach was over-simplified and did not adequately consider the effect the financial markets have had on the earnings of pension funds since 2000. In addition, the Board found that IPL has no control over market downturn, decreasing interest rates, or increases in medical trend rates, and both direct and indirect costs have been determined by IPL’s actuary. The Board allowed the total amount determined by the actuary as reasonable. The evidence in this proceeding supports the same result. The adjustment in this proceeding is $330,632. Consistent with the decision in the electric rate proceeding, the Board will direct IPL to obtain Board approval for the trust account in which the resulting reserves are to be deposited pursuant to 199 IAC 7.11(3)"b."

H. Pension Expense

IPL proposed using a one-year level to determine pension expense based upon actuarial estimates. Consumer Advocate proposed a three-year average.

This is substantially the same issue as was decided in the electric rate proceeding. In that proceeding, the Board accepted IPL's adjustment. The Board finds that the evidence in this proceeding supports the same result. The adjustment in this proceeding is $641,634.

I. Property Tax

IPL agreed with Consumer Advocate's adjustment of $7,889 and this is consistent with the same issue in the electric rate proceeding. The Board will adopt Consumer Advocate's adjustment.

J. Cash Working Capital-Revenue Collection Period

IPL proposed an adjustment of $170,629 based upon the change in rate base, which resulted from the difference between a revenue collection period of 27.1 days over 21.9 days and amortizing the difference over three years. Consumer Advocate argued the 27.1-day collection period is abnormally high due to the inclusion of the winter of 2000-2001.

The evidence concerning this issue is the same as addressed in the electric rate proceeding. In that proceeding, the Board accepted IPL's three-year amortization. The Board will accept IPL's three-year amortization in this proceeding. The adjustment in this proceeding is $170,629.

K. Gas Code Compliance

IPL proposed an adjustment for the cost associated with gas code compliance. IPL first proposed an adjustment of $868,500, then revised the adjustment to $300,085 while claiming that expenditures through August 2002 were $222,966 and capitalizing much of the cost. Consumer Advocate proposed an adjustment of $222,966. Consumer Advocate argued that IPL's adjustment is based on estimates of budget item costs, non-budget item costs, and strategic item costs.

This issue is unique to this proceeding. The Board finds that the adjustment proposed by Consumer Advocate will be accepted since it is known and measurable. The IPL estimates varied dramatically and are based upon projected expenditures and are, therefore, not known and measurable.

L. Former Manufactured Gas Plant Costs (FMGP)

IPL and Consumer Advocate agree that $5.1 million is a representative amount of cost to include in this proceeding for former manufactured gas plant (FMGP) remediation.

ADM and Equistar proposed that the $5.1 million be shared between ratepayers and shareholders 70 percent and 30 percent, respectively, to give IPL an incentive to keep costs reasonable.

The Board finds that it has consistently approved the inclusion in rates of a representative amount of FMGP remediation costs. There is no precedent for sharing those costs between ratepayers and shareholders. The Board will approve the inclusion in rates in this proceeding of $5.1 million for FMGP remediation.

The FMGP sites need to be cleaned up in as efficient and cost effective manner as possible. One possibility for reducing the length and cost of remediation is the Land Recycling Program. The Board will direct IPL to begin discussions with the Iowa Department of Natural Resources (IDNR) for use of the Land Recycling

Program to reduce remediation costs. The Board will also direct IPL to file a report twice a year showing the amount of remediation expenditures budgeted for that year by site and in total and the amounts actually expended in total and by site. The report shall include information concerning discussions with IDNR and any efforts undertaken as a result of those discussions.

M. Former Manufactured Gas Plant Recoveries

IPL initially proposed that the treatment of insurance recoveries associated with the FMGP sites be considered in a separate proceeding. In rebuttal testimony, IPL then proposed that the Board address the treatment of the recoveries in this proceeding. IPL argued that it should be allowed to retain the insurance recoveries based upon its calculations that it has expended more for remediation costs than it has recovered from ratepayers and insurance recoveries. IPL opposed sharing the recoveries between ratepayers and shareholders as the Board ordered in 2001 with regard to insurance recoveries by IES.

Consumer Advocate proposed that 90 percent of the insurance recoveries be returned to ratepayers and 10 percent to shareholders, as the Board ordered for IES in 2001. Consumer Advocate also disagreed with the allocation factor used by IPL to determine Iowa's share of recoveries.

ADM and Equistar recommended the Board adopt the same treatment for insurance recoveries as the Board ordered for IES in 2001.

The Board finds that the issue of the treatment of the insurance recoveries associated with FMGP sites should be considered in a separate proceeding. This issue was not presented until rebuttal testimony and the Board is not satisfied that it has all of the evidence necessary to make a reasoned decision. The Board will direct IPL to file a refund plan consistent with IPL's position in this proceeding for Board consideration.

VI. RATE OF RETURN

A. Cost of Equity

The evidence regarding the appropriate return on common equity for IPL in this proceeding was based upon analyses of two different companies. Most of the evidence addressed the cost of equity of IPL as part of the revenue requirement calculation. Other evidence, recognizing the concept of double leveraging, addressed the cost of equity of AEC, IPL's parent company. Many differences exist among the witnesses in the form and application of the various costs of equity models presented. The Board considered similar evidence and models in the electric rate proceeding. There were fewer witnesses on this issue in this proceeding while much of the analysis in the Board's electric rate proceeding order is relevant to this proceeding.

The primary recommendations on return on equity in this proceeding were as follows: IPL 12.1 percent, Consumer Advocate 9.6 percent, ADM and Equistar 10.4 percent. MidAmerican did not present a witness for return on equity in this proceeding but argued in its brief that the risk premium range should be adjusted to 350 to 650 basis point range to reflect the decline in the yields of the A-rated public utility bonds.

As found in the electric rate proceeding, the Board continues to believe that DCF analysis should look at both historical and forecasted estimates for growth rates and continues to prefer the Federal Energy Regulatory Commission (FERC) DCF model for these purposes. In determining the return on equity, the Board has generally looked first at the results under the various discounted cash flow (DCF) models. The Board will not consider the DCF models using AEC as a proxy because of recent financial volatility, the changing views of the rating agencies, and the widely divergent results. IPL indicates in its brief that AEC should not be used as a proxy. Considering the primary DCF analysis of each party and the mean average of the each party’s recommendations results in a range of returns from 10.7 percent to 11.13 percent.

The Board will use a risk premium model to check or validate the DCF results. The parties presented various positions on the proper calculation of the risk premium to be used in the validation. The Board has historically used a risk premium approach that adds 250 to 450 points to the most recent yield of A-rated utility bonds. The Board finds that this model of the risk premium approach is still valid in this proceeding.

Using the Board’s risk premium approach and the most recent A-rated utility bond yield from February 2003, the cost of equity range is 9.43 percent to 11.43 percent, with a midpoint of 10.43 percent. This midpoint falls below the DCF range of 10.7 to 11.13.

The Board's order in the electric rate proceeding was issued April 15, 2003, just a few weeks before this order is issued. The Board found based upon very similar financial data that a return on common equity of 11.15 percent was reasonable for IPL in the electric rate proceeding. The A-rated utility bond yield though has declined from the 7.23 percent used in the electric rate proceeding to the more recent 6.93 percent presented in this proceeding. The 30 basis point decline in the yield is reflected in the lower risk premium midpoint in this proceeding and suggests perhaps that the return on equity for IPL's gas operations should be below 11 percent.

The evidence in this proceeding presents the Board with two points of reference for the return on equity for IPL. Those are the return on common equity established on April 15, 2003, in the electric rate proceeding and the more current economic indicators evidenced by the decline in the A-rated utility bond yield. The Board also has a reference point of the 11.05 percent return found reasonable for interim rates in this proceeding on October 4, 2002.

The Board finds that adopting the 11.15 percent approved in the electric rate proceeding would be an upward move from the 11.05 percent found reasonable for interim rates that the evidence in this proceeding does not support. The Board finds, however, that the current decline in the A-rated utility bond yield does not reflect what the Board considers to be improving economic conditions. Recognizing that the evidence in this proceeding supports a lower return on equity than did the evidence in the electric rate proceeding, the Board finds that a return on equity of 11.05 found reasonable for interim rates is still reasonable. This is within both the DCF range and the Board's risk premium range. As the Board has noted on prior occasions, determining the appropriate return on equity is not an exact science and other persons looking at this record might reach a different conclusion. However, the return selected is well within the zone of reasonableness, based on the evidence presented.

B. Capital Structure

The evidence concerning the capital structure to use in determining IPL's gas operations revenue requirement is similar to that presented in the electric rate proceeding. In this proceeding, IPL proposed the same adjustments to its test year capital structure for events that were expected to occur in 2002. Among the changes proposed was the redemption of higher coupon long-term debt, retirement of $56.4 million of outstanding preferred equity securities, the issuance of $150 million of redeemable cumulative preferred or trust preferred equity securities, and an approximately $150 million equity contribution to IPL. IPL stated that these changes were made in an attempt to create a capital structure that would help it maintain its long-term corporate credit rating of "A-" by Standard and Poor's.

Consumer Advocate proposed the use of the 13-month average test year capital structure and opposed IPL's reflection of post-test year financing adjustments. Consumer Advocate pointed out that there is no assurance that the proposed transactions will be completed and that IPL has deferred the completion of the equity infusion until sometime in 2003, possibly 18 months after the test year. Consumer

Advocate also argued that use of the 13-month average capital structure is consistent with Board precedent.

The evidence shows that there are two main factors different in this proceeding than in the electric rate proceeding. First, IPL's debt rating has been downgraded to a BBB+ and, second, the cost of the newly-issued preferred equity securities is known and is significantly higher than the redeemed preferred stock.

The Board finds that consistent with its decision in the electric rate proceeding, it will not abandon the use of the 13-month average capital structure. As stated by the Board in the electric proceeding, there is no evidence that most of the expected changes have actually occurred or will ever occur. In addition, the changes proposed to the capital structure were intended to shore up credit ratings and the Board is not yet persuaded that such adjustments should be allowed when the cause of the lower credit ratings may be with non-regulated activities. Finally, the additional evidence does not support a change from this decision since it does not have a direct effect on the capital structure for this proceeding.

C. Double Leverage

Double leverage is the use of debt by both the parent company and the subsidiary, in combination with the parent's equity capital, to finance the assets of the subsidiary. IPL and MidAmerican presented arguments against the use of double leverage and Consumer Advocate presented arguments in support of the use of double leverage. The Board adopted the use of double leverage in the electric rate proceeding to account for the parent's accessibility to lower cost debt to purchase equity in its subsidiary upon which it may earn a higher rate of return than it pays for the debt. The Board found that use of double leverage recognizes the true capital structure at the subsidiary level and prevents the parent company's stockholders from earning a windfall from regulated rates. In the electric rate proceeding, the Board was not persuaded to disavow the application of double leverage in all instances.

The Board finds that the evidence in this proceeding also supports use of double leverage. Double leverage is a regulatory tool utilized to help protect the regulated utility from abuse by its parent company. The Board recognizes the complex nature of the relationships and transactions between a parent and its regulated subsidiary and does not apply double leverage without first considering the facts and circumstances presented in each proceeding.

IPL has argued that the application of double leverage in this proceeding and the basic premise of double leverage violates the 14th Amendment of the United States Constitution. IPL argued that using double leverage as proposed by Consumer Advocate would result in a return on equity of less than 9 percent which would be confiscatory. As cited in the electric rate proceeding, the Iowa Supreme Court has affirmed the Board's use of double leverage on at least two occasions. General Telephone Co. of the Midwest v. Iowa State Commerce Comm'n, 275 N.W.2d 364 (Iowa 1979); United Telephone Co. v. Iowa State Commerce Comm'n, 257 N.W.2d 466 (Iowa 1977). The Board's order provides IPL with the opportunity to earn a return which the Board finds reasonable and the Board has determined a reasonable return on common equity consistent with past decisions. The Board finds that the use of double leverage in this proceeding does not result in a confiscatory return on common equity.

One of the specific double leverage issues in this proceeding is whether to apply double leverage to a $24 million debt issue. The debt issue originated in 1994 prior to the formation of AEC, IPL's parent. IPL contends that debt issued by a prior holding company before the merger with IPL's holding company should not be considered evidence of double leverage in the context of a newly-formed parent company and unrelated subsidiary eight years later.

Consumer Advocate pointed out that AEC infused common equity into IPL in September 2002. Additionally, the dollars received and spent by IPL are fungible and it is impossible to trace the disbursement of the dollars received from any source for any specific purpose.

The evidence in this proceeding supports the same findings on this issue as were made in the electric rate proceeding. The Board based its decision on the failure of IPL to meet all four of the factors for disproving the reasonableness of double leverage established in <u>Iowa Electric Light and Power Company</u> Docket Nos. RPU-89-3 and RPU-89-9. The Board found that IPL failed to satisfy the fourth criteria, that the only increase to common equity since inception had been through an increase in the utility's retained earnings. AEC has infused capital into IPL since the merger and this activity at the parent level supports the utility's capital structure.

The Board recognizes that there may be appropriate exceptions to the application of double leverage other than one based on the four-factor test the Board has used. However, the evidence in this case is not persuasive for the application of a new exception.

D. Applying Double Leverage To Guaranteed Debt

Consumer Advocate, in this proceeding as in the electric rate proceeding, has also included in its double leverage adjustment AER's debt that is guaranteed by AEC. Consumer Advocate contends that AER could not have issued the debt if IPL was not part of the AEC companies. IPL argued that this adjustment would jeopardize its financial ability to meet its ongoing commitments and to attract future capital. MidAmerican and IPL made these same arguments in the electric rate proceeding.

In the electric proceeding, the Board found that the proposed adjustment was a non-traditional use of double leverage and was contrary to the premise that the parent issues debt in order to infuse equity into a utility subsidiary. The Board determined that AER is the non-regulated subsidiary of AEC and that AER's debt is kept separate from IPL and had not been used to infuse equity into IPL. Although AEC has fully and unconditionally guaranteed AER's debt, the evidence shows that IPL is not responsible for paying the debt if there is a default and none of its assets were pledged as collateral for the debt. Most importantly, the proceeds from the debt were not used to invest in the common equity of IPL. The underlying theory behind a double leverage adjustment is, therefore, not present.

The Board finds that the evidence in this proceeding supports the same decision as made by the Board in the electric rate proceeding. The AER debt will not be used in the double leverage adjustment.

VII. COST OF SERVICE

A. Classification and Allocation of Mains

IPL proposed the use of a minimum system to determine the customer-related cost component of gas mains and allocating the remaining demand-related component according to class non-coincident peak (NCP) demands. This combined method allocates 59 percent of the main costs to the Residential class.

Consumer Advocate opposed use of the minimum system concept for determining customer-related main costs and opposed use of the NCP method for allocating demand-related main costs. Consumer Advocate proposed the use of an Average and Excess (A&E) method for allocating all main costs.

There is no clear Board precedent on the proper method for classifying mains into separate demand and customer related costs. The Board has approved use of the minimum system and NCP methods in previous IES rate proceedings (Docket Nos. RPU-89-3 and RPU-92-9) and use of the A&E method in more recent IPC rate proceedings (Docket Nos. RPU-92-11 and RPU-95-8). The Board has consistently favored the A&E method in electric rate proceedings. In adopting cost of service rules for electric utilities, the Board stated that transmission and distribution costs are related primarily to demands on the system and not the number of customers served.

The Board finds that the use of a minimum system for classifying mains into separate customer and demand components presented by IPL is not reasonable since it is based upon the existence of a distribution system whose sole purpose is to make gas available to customers who are assumed not to want gas and that would not be capable of delivering the gas to customers if desired.

Although the Board did not accept the use of a minimum system in the last IPC rate case, Docket No. RPU-95-8, it offered to consider the concept in a future proceeding. The evidence presented by IPL in this proceeding is not sufficient for the Board to adopt the minimum system method. IPL presented only one study and little supporting evidence for the method. The Board will adopt Consumer Advocate's classification of all transmission and distribution mains as demand-related and Consumer Advocate's A&E method for allocating main costs.

B. Allocation of Former Manufactured Gas Plant Costs

IPL proposed to allocate the costs for former manufactured gas plant (FMGP) remediation across all zones on a systemwide basis. IPL contends that FMGP costs are not related to any current operations and should be recovered on a systemwide basis.

ADM and Equistar proposed that FMGP remediation costs should be directly assigned to the zones where the FMGP sites are located. Consumer Advocate did not brief this issue but opposed the reduction of the former IPC Clinton and Mason City zones' allocation of FMGP remediation costs.

The Board finds that FMGP remediation costs are not caused by any existing group of customers and no group of customers receives a benefit from the remediation. The costs, therefore, should be spread across all zones on a system wide basis. IPL proposed a composite formula for allocating FMGP costs, based 75 percent on class shares of non-gas revenue margins and 25 percent on throughput volumes. This composite formula was not contested.

C. Labor Allocation Factor

IPL accepted ADM and Equistar's labor allocation factor and Consumer Advocate did not oppose the factor. ADM and Equistar proposed to allocate demand-related other labor expense by the same factor used to allocate demand-related other plant. The Board will adopt this change.

VIII. RATE DESIGN

A. Rate Equalization and Consolidation

IPL proposed a consolidated class cost-of-service study for the four rate zones (IES North, IES South, IPC Mason City, and IPC Clinton) and for allocating costs across four consolidated customer classes: Residential, General Service (maximum daily usage of 200 Dth or less), Large General Service (LGS) (maximum daily usage greater than 200 Dth), and LGS Contract Demand (two large customers in the IPC Clinton zone).

Consumer Advocate did not oppose IPL's consolidated class cost-of-service study.

ADM and Equistar proposed that costs continue to be assigned separately to those zones with customers that caused the costs to be incurred.

These arguments are similar to those in the electric rate proceeding. That is, they concern the question of whether IPL should be regarded as a single, integrated system or as a collection of separate, independent systems. There are no Board rules for gas utility cost of service similar to those for electric utilities. The Board has a long and consistent history of favoring cost allocation on a system wide basis and favoring zone equalization and class rate consolidation. The Board finds that IPL's proposal fulfills the goal of rate equalization.

In addition, the Board will approve IPL's proposal to consolidate class rate structures. Rate shock does not seem to be an issue in IPL's proposal. Any change in the final class revenue requirements approved for IPL in this proceeding should be matched by uniform percentage adjustments to the class-specific, non-gas rate elements in IPL's proposed class rate structures.

B. Customer Charge Levels

IPL proposed a uniform $10.50 charge for Residential customers and a uniform $16.50 charge for General Service customers.

Consumer Advocate proposed a uniform $7.75 charge for Residential customers and a uniform $12 charge for General Service customers.

The Board finds that the customer charges proposed by IPL are reasonable. Even though there is no precedent on this issue for gas utilities, the Board's electric cost of service rule, 199 IAC 20.10(2)"e," provides some guidance and was used as the basis for each party's position. The inclusion of a portion of general and common costs in customer cost seems to be an accepted practice for electric rate cases. For example, in the electric rate proceeding, Consumer Advocate's witness included a markup for A&G overheads in customer cost calculations. The Board will adopt IPL's customer charges as adjusted for the class revenue requirements approved for IPL in this proceeding.

C. Uncontested Miscellaneous Changes

There are four uncontested miscellaneous changes to rate design proposed by IPL. The four changes relate to: 1) reconnection and posting charges; 2) transportation balancing provisions; 3) interruptible service telemetering; and, 4) gas main and service line extensions. The Board will adopt IPL's miscellaneous changes.

IX. FINDINGS OF FACT

Based on a thorough review of the entire record in these proceedings, the Board makes the following findings of fact:

1. It is unreasonable to include a year-end rate base adjustment for determining rate base in this proceeding.

2. It is reasonable to include rate base using a 13-month average rate base as proposed by Consumer Advocate in this proceeding.

3. It is reasonable to allow a net adjustment of $427,827 for the vehicle replacement program and a corresponding adjustment to the income statement of $6,177.

4. It is reasonable to allow IPL's adjustments to the enterprise resource-planning project and provide for an amortization period of three years for one-time expenses and five years for depreciation expense.

5. It is unreasonable to make any adjustment associated with merger savings.

6. It is unreasonable to include in test year expenses any amounts associated with MICP and EICP awards.

7. It is reasonable to allow the costs determined by an actuary of $330,632 for post-employment benefits other than pensions.

8. It is reasonable to allow the cost determined by an actuary of $641,634 as a representative level of pension expense.

9. It is reasonable to allow an adjustment of $7,889 for property taxes.

10. It is reasonable to allow an adjustment of $170,629 for a three-year amortization associated with a revenue collection period of 27.1 days.

11. It is reasonable to allow an adjustment of $222,966 for gas code compliance.

12. It is reasonable to allow a representative amount of FMGP remediation costs of $5.1 million without any sharing of the costs by shareholders.

13. It is reasonable to apply double leverage to $24 million of AEC debt.

14. It is unreasonable to apply double leverage to AER's debt that is guaranteed by AEC.

15. It is reasonable to set the return on common equity at 11.05 percent.

16. It is reasonable to use a consolidated class cost of service study for the four rate zones: IES North, IES South, IPC Mason City, and IPC Clinton.

17. It is unreasonable to use a minimum system method to determine the customer-related cost component of gas mains and unreasonable to use the NCP method for allocating demand-related main costs.

18. It is reasonable to use Consumer Advocate’s average and excess method for allocating main costs.

19. It is reasonable to allocate FMGP remediation costs across all the rate zones on a systemwide basis as proposed by IPL.

20. It is reasonable to use ADM and Equistar’s labor allocation factor.

21. It is reasonable to adopt IPL’s consolidated class rate structures, with uniform percentage adjustments to the class-specific non-gas rate elements to match the final class revenue requirements approved in this order.

22. IPL’s proposed customer charge levels are reasonable, as adjusted to match the final class revenue requirements approved in this order.

23. It is reasonable to adopt IPL’s four uncontested changes to rate design.

X. CONCLUSIONS OF LAW

The Board has jurisdiction of the parties and the subject matter in this proceeding, pursuant to Iowa Code chapter 476 (2003).

XI. ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The proposed tariffs filed by Interstate Light and Power Company on July 15, 2002, identified as TF-02-424 and TF-02-425, and made subject to investigation in this proceeding, are declared to be unjust, unreasonable, and unlawful.

2. Interstate Power and Light Company shall file a revised cost allocation study, a revised class cost-of-service study, and revised tariffs setting schedules of gas rates in compliance with the findings of this order and attached schedules A through D on or before 15 days from the date of this order. Schedules A through D are incorporated into this order by reference. The compliance tariffs shall become effective upon approval by the Board.

3. Interstate Power and Light Company shall file a refund plan for the return of the overcollection of revenue under the interim rates approved by the Board on October 4, 2002, on or before 15 days from the date of this order.

4. Interstate Power and Light Company shall contact the Iowa Department of Natural Resources concerning the use of the Land Recycling Program to reduce the time and costs of remediation of former manufactured gas plant sites.

5. Interstate Power and Light Company shall file with the Board on March 15 and October 15 annually a report detailing projected expenditures in total and by site and the actual expenditures in total and by site for former manufactured gas plant site remediation. The reports shall include a summary of any discussions

with the Iowa Department of Natural Resources concerning the use of the Land Recycling Program.

6. Interstate Power and Light Company shall file a refund plan addressing the insurance recoveries associated with former manufactured gas plant sites on or before June 16, 2003.

7. Motions and objections not previously granted or sustained are denied or overruled. Any argument in the briefs not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comments.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

CONCURRING OPINION OF ELLIOTT G. SMITH
DOCKET NO. RPU-02-7

I agree with the result of this order and agree that the rates granted Interstate Power and Light Company (IPL) are just and reasonable.

I respectfully disagree, however, with the majority’s decision to deny IPL's year-end rate base adjustment. I believe that the methodology used by IPL effectively annualized all additions, retirements, and revenue for the calendar year. As a result, I am not convinced that a violation of the matching principle has occurred. IPL has demonstrated that a year-end rate base, when properly calculated, annualizes all elements of rate base added or retired from rate base throughout a year. In addition, IPL proposed a customer adjustment that was not contested and this adjustment resulted in an appropriate increase in revenue calculation to match the year-end rate base level.

With the difference of opinion concerning the year-end rate base adjustment duly noted, I will still concur with the order in all other regards.

/s/ Elliott G. Smith

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

Dated at Des Moines, Iowa, this 15th day of May, 2003.

Schedule A

INTERSTATE POWER AND LIGHT COMPANY
Revenue Requirement
RPU-02-7

Line No.	Item	Amount (A)
1	Rate Base	$172,308,622
2	Rate of Return	9.032%
3	Required Return	$15,562,449
4	Less: Adjusted Operating Income	$7,771,626
5	Net Operating Income Deficiency	$7,790,823
6	Income Tax Effect	$5,542,778
7	Revenue Deficiency/(Excess)	$13,333,600
8	Plus: Adjusted Test Year Revenues	$251,141,469
9	Revenue Requirement	$264,475,069

Schedule B

INTERSTATE POWER AND LIGHT COMPANY
Revenue Requirement
RPU-02-7

Line No.	Description	Adjusted Amounts (A)
1	Utility Plant in Service	300,659,191
2	Accum. Depr. & Amort.	(117,443,192)
3	Net Plant	183,215,999
	Additions:	
4	Materials and supplies	798,589
5	Prepayments	173,141
6	Cooper contractual payments	14,036,081
7	Cash working capital	(3,106,789)
	Deductions:	
8	Accumulated deferred income taxes	(18,761,862)
9	Customer advances	(399,939)
10	Customer deposits	(839,541)
11	Unclaimed property	(7,207)
12	Accu. prov. for uncollectibles	(265,575)
13	Accrued liability account	(1,356,632)
14	Accrued vacation	(688,882)
15	Accrued pension plan obligations	(488,761)
16	Other deductions	-
17	Total Rate base	172,308,622

INTERSTATE POWER AND LIGHT COMPANY
Revenue Requirement
RPU-02-7

Alliant Energy Corporation
Weighted Average Cost of Capital

Line No.	Description	Amount (A)	Ratio (B)	Cost Rate (C)	Weighted Cost (D)
1	Long-Term Debt	$ 24,000,000	1.327%	8.590%	0.114%
2	Preferred Stock	$ -	0.000%	0.000%	0.000%
3	Common Stock	$1,784,023,634	98.673%	11.050%	10.903%
4	Total	$1,808,023,634	100.000%		11.017%

Interstate Power and Light Company
Weighted Average Cost of Capital

Line No.	Description	Amount (A)	Ratio (B)	Cost Rate (C)	Weighted Cost (D)
5	Long-Term Debt	$ 812,853,770	48.567%	7.294%	3.542%
6	Preferred Stock	$ 60,178,519	3.596%	6.086%	0.219%
7	Common Stock	$ 800,653,127	47.838%	11.017%	5.270%
8	Total	$1,673,685,416	100.000%		9.032%

INTERSTATE POWER AND LIGHT COMPANY
Revenue Requirement
RPU-02-7

Schedule D

Line No.	Description	Adjusted Amounts (A)
1	Operating Revenues	$264,475,069
2	**Operating Expenses:**	
3	Gas Purchased for Resale	$191,867,179
4	Operations Expenses	$31,963,956
5	Maintenance Expenses	$3,770,395
6	Depreciation and Amortization	$9,476,926
7	Other Taxes	$1,083,293
8	**Income Tax:**	
9	Current Federal	$5,070,899
10	Current State	$1,583,376
11	Deferred	$496,395
12	Investment Tax Credits	($244,314)
13	Total Operating Expenses	$248,912,620
14	Net Operating Income	$15,562,449